IN THE HIGH COURT OF JUDICATURE FOR RAJASTHAN AT JODHPUR

JUDGMENT

CIT, Udaipur Vs. M/s. Hindustan Zinc Ltd.,Udaipur

D.B. INCOME TAX APPEAL NO.6/2003
against the order dated 22.11.2001 passed in ITA No.1232(JP)/94 for assessment year 1979-80.

Date of judgment : 4th January, 2007

PRESENT

HON'BLE MR. JUSTICE RAJESH BALIA
HON'BLE MR. JUSTICE CHATRA RAM JAT

Mr. K.K. Bissa for the appellant.
Mr. Anjay Kothari for the respondents.

BY THE COURT:- (PER HON'BLE RAJESH BALIA, J.)

This appeal is directed against the order of the Income Tax Appellate Tribunal, Jodhpur Bench, Jodhpur dated 22nd Nov., 2001 for the assessment year 1979-80 the relevant previous year of which ended on 31st March, 1979. The question that was framed for consideration in this appeal as substantial question of law at the time of admission reads as under:-

> "Whether in the facts and circumstances of the case, the Tribunal was justified in deleting the amount received from the Insurance Company indemnifying the assessee for the loss caused on account of loss of machinery which was destroyed in fire with reference to provisions of capital gains by ignoring the provisions of Section 41(2), which relates to computation of income, otherwise then by way of capital gains?

During the previous year ending on 31st March, 1979, the assessee had received Rs.5,89,055/- as an insurance claim on account of loss of certain machinery which was destroyed in fire. The Assessing Officer made additions of this amount chargeable under Section 41(2) of the Income Tax Act as balancing charge.

The appeal against the assessment order dated 20th January, 1983 was dismissed by CIT (Appeals) vide order dated 8th March, 1994. Significantly the Assessing Officer did not refer to the cost of acquisition of the destroyed machine, depreciation if any allowed

thereon or written down value of the machine destroyed in fire. However, the CIT (Appeals) in her order has categorically found that written down value or the cost of acquisition assets was not known though on principle she noticed that the insurance claim should have been reduced from the cost of assets and the written down value should have been adjusted.

Be that as it may, in further appeal, the Tribunal vide its order dated 22nd Nov., 2001 allowed the assessee's appeal in this regard by holding that Section 41 (2) of the Act is not applicable unless the machine or the capital assets on which depreciation has been claimed is destroyed as a consequence of an act or omission on the part of the assessee. Since the loss of machinery was due to fire was not caused by the act of the assessee, the Section 41(2) is not attracted. It was also opined that since no transfer of the assets was involved in any sense of the term which has been destroyed by fire, the question of levy of tax on capital gains or on any money received above cost of acquisition also would not arise inasmuch as for the purpose of levy

of capital gains, transfer of assets by any means known to law must take place. In the process, Tribunal has also held that extinguishing of right does not amount to transfer.

At the outset, we may notice that learned counsel for the appellant has brought to our notice the decision of the Supreme Court rendered in Commissioner of Income Tax Vs. Mrs. Grace Collis and others 248 ITR 323 to urge that even extinguishment of right is one of the mode of transfer of assets and, therefore, the Tribunal has erred in holding that no capital gains can be said to have arisen out of extinguishment of the right in machinery in the present case and, therefore, applicability of capital gains under Section 45 was attracted.

This contention is stated to be rejected. It is not a case which relates to extinguishment of right of assessee in assets followed with creation of right in another assets as it happens in the case of a scheme of amalgamation or merger of the companies which was

the case before the Supreme Court whereas as a result of amalgamation two companies the existing shareholder of amalgamating company is allotted shares of the amalgamated company in lieu of extinguishing of its rights in the company which has ceased to exist. This provides altogether different case study. In case of amalgamation or reassessment of two or more companies right to the assessee to the assets is not destroyed altogether but he cease to be a share holder of a company which has merged into another and in lieu of his existing right in merged company he is allotted share in the new company which comes into existence as a result of merger. This in ultimate analysis amounts to exchange, which was in all circumstances, the Supreme Court in the case of Commissioner of Income Tax Vs. Mrs. Grace Collis and others 248 ITR 323 had held that extinguishment of any right of capital assets is not excluded from the definition of transfer given under the Income Tax Act and the definition of transfer in the Income Tax Act includes extinguishing right of holder of share in the amalgamated company.

Apparently this case offers no parallel with the facts of the present case in which the instance is not confined to extinguishment of the right of the assessee in a particular assets to be substituted by another but is a case where the asset itself is destroyed and extinguished.

Section 45 as was existing during the period in question had no application to a case where compensation or damages were received for an assets which has been destroyed and which could not have been transferred in any sense of the terms.

In fact, neither the Assessing Officer nor the CIT (Appeals) had sought to tax the amount received from the insurance company by way of a capital gains nor it was the claim raised before the Tribunal and Tribunal was not required to go into such question.

The contention that receipt from insurance company was liable to be considered under the provisions of Section 45, is to be rejected.

The reference may be made in this connection to subsequent amendment made in Section 45 by inserting Sub-Section (1A) w.e.f. 1.4.2000 vide Finance Act, 1999. By this new provision a legal fiction was created that where any person receives, at any time, during any previous year any money or other assets under an insurance from an insurer on account of damage or destruction of any capital assets as a result of accident, fire or other contingencies stated therein then any profits or gains arising from receipt of such money or other assets shall be chargeable to Income Tax under the head capital gains and shall be deemed to be the income from such previous year in which such assets or money was received.

Since the provisions are prospectively in operation w.e.f. 1.4.2000, it has no bearing on the computation of total income for the year 1978-80 with which we are concerned.

Coming to the second aspect of the matter

whether the money received from insurance company was liable to be subjected to consideration under Section 41(2) of the Income Tax Act, we are of the opinion that the answer must be emphatic yes. There is no justification to sustain the view taken by the Tribunal that unless the machinery or asset is sold, demolished or destroyed consequent to an act or application on the part of the assessee, the provision is not attracted to Section 41 (2) of the Act of 1961. Sub-section 2 of Section 41 of the Income Tax Act reads as under:-

> "(2) Where any building, machinery, plant or furniture which is owned by the assessee and which was or has been used for the purposes of business or profession is sold, discarded, demolished or destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value, if any, exceed the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to income-tax as income of the business or profession of the previous year in which the

moneys payable for the building, machinery, plant or furniture became due:

Provided that where the building sold, discarded, demolished or destroyed is a building to which Explanation 5 to 43 applies, and the moneys payable in respect of such building, together with the amount of scrap value, if any exceed the actual cost as determined under the Explanation, so much of the excess as does not exceed the difference between the actual cost so determined and the written down value shall be chargeable to income-tax as income of the business or profession of such previous year:

We may notice that a second proviso was inserted in the aforesaid provision w.e.f. 1.4.1981 which is not relevant for the present purpose and the sub-section as a whole was omitted from the statute book w.e.f. 1.4.1988 vide Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986, and the provision in modified form has been reintroduced w.e.f.1.4.1998. Since the present case relates to assessment year 1979-80 when sub-section (2) of Section 41 was operative in

the aforesaid form, the present case shall be governed by the aforesaid provisions.

A perusal of Sub-section (2) of Section 41 makes it clear that it has been devised to tax whatever amount is recovered by the assessee from the building, machinery, plant or furniture which were used for the purpose of business or profession as a result of its sale, discard, demolish or **'destruction to the extent it relates to recovery of any claim to deduction'** in respect of such building machinery, plant or furniture **that has been allowed to the** assessee while computing his income chargeable to tax for earlier years. It is one of the cardinal principle of the Income Tax, which is embodied in Section 41 and its various provisions, that wherever any deduction has been allowed to the assessee and subsequently if wholly or any part of such expenses or claim have been recovered by the assessee in any way to that extent the earlier claim to deduction becomes unjustified and must be brought to tax. It is to give effect to this principle that this provision has been enacted. In simple term, though the term 'balancing

charge' has not been used in statute but has been coined by the judicial pronouncement as a principle that in the matter of capital assets on which depreciation has been charged at its cost of acquisition to the profit and loss account resulting in reduction of net profit chargeable to tax and by adjusting the depreciation amount against the cost of acquisition, the written down value comes down on receiving of any sum over and above its WDV as an outcome of its sale or scrap of such capital assets used in the business of the assessee, but not exceeding the cost of acquisition is to be taxed as balancing charge of depreciation allowed and recovered. Therefore, if on the destruction of assets any money is received from the insurance company, which is a subject of contract of indemnity, it acquires the character of recovering the loss and, therefore, to the extent the recovery from the insurance claim is in excess of written down value that is to say the cost of acquisition reduced by depreciation actually allowed as deduction is liable to be brought back to tax as revenue receipt.

We are, therefore, of the opinion that the

Assessing Officer as well as the CIT (A) were right, the amount received from the insurance company was liable to be dealt with under Section 41(2).

However, the two essential conditions for operating section 41 (2) are to determine the cost of acquisition of assets so sold, discarded or demolished or destroyed and its written down value if depreciation in respect of which has been allowed or any other deduction in respect of such assets is allowed resulting in reduction of its cost of acquisition for the purpose of computation of income tax per year has to be determined. Any amount received over and above cost of acquisition is not liable to be dealt with under Section 41(2). If no deduction in respect of such assets has been claimed and the cost of acquisition has not been reduced to the written down value then nothing becomes chargeable to Section 41(2). So also if the recovery is less than its WDV, nothing become includible in income u/s 41(2). But if any amount is received in respect of such asset over and above its written down value upto its cost of acquisition is to be included in taxable income

for the relevant assessment year.

We are constrained to observe that while Assessing Officer has not at all applied its mind and referred to any such finding about the cost of acquisition or written down value so as to work out the balancing charge liable to be taxed as profit of the business relating to the previous year in question, the CIT (A) though has noticed that it is not known what is cost of acquisition or written down value but has not made any attempt to record a finding about its OAWDV or any deduction claimed in respect of such assets by way of depreciation. That would have been matter of record. In the absence of such determination, while amount received could not have been brought to tax under Section 41(2) as balancing charge. The very fact that the entire amount received from the Insurance Company without reference to the cost of machinery destroyed or its written down value has been added as profits of the assessee relating to assessment year 1979-80 goes to show that no application of mind has been applied. Since the method of depreciation which could result in

reduction of the cost of the assets to Zero is not applicable to the deduction on account of depreciation by Income Tax Act, there could not have been Zero written down value in respect of the assets in question which has been destroyed by fire, therefore, the entire amount could not have been brought to the tax under Section 41(2) in absence of the finding about the cost of acquisition, it cannot be said that the amount received from the insurance was less than the cost or written down value. Therefore, the addition as such could not have been sustained. If such amount is not computable then too by applying the principle laid down by the Supreme Court in M/s Grace Colice's where the computation of a sum is not practicable, it cannot be included in computation of total income. Hence, in absence of any finding about the cost of acquisition and the written down value of the machine destroyed, the additions made in the income of the assessee as profits and gains from his business on account of insurance claim received during the year of loss of machine by fire cannot be sustained. No material has also been placed before us to hold a further inquiry into the cost of

acquisition and the written down value.

In that view of the matter, the order of Tribunal setting aside the additions made does not require to be interfered with. However, it needs to be remitted back to Assessing Officer to hold an enquiry into the cost of acquisition of the machine destroyed, any claim of deduction on account of depreciation, if any, allowed and find the WDV and then consider the issue whether any sum is includible in income u/s 41(2) of the Income Tax Act.

Appeal is disposed of with these directions. No costs.

[CHATRA RAM JAT], J. [RAJESH BALIA], J.

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